



CITY OF HOUSTON

Office of the Mayor

Lee P. Brown

Mayor

P.O. Box 1562
Houston, Texas 77251-1562
901 Bagby, 3rd Floor
Houston, Texas 77002

T. 713.247.2545
F. 713.247.1067
www.cityofhouston.gov

October 16, 2002

To: Members of the City Council, City Controller,
Employees and Citizens of the City of Houston

From: Lee P. Brown, Mayor

Subject: Adopted Budget for Fiscal Year 2003

This document contains City of Houston's adopted budget for the fiscal year that begins July 1, 2002 and ends June 30, 2003 ("FY03"). This budget has been developed with the assistance of members of the City Council. Although full agreement is never easy with our democratic system, most of the highest priorities of the Council Members have been incorporated. In particular, this budget includes a continuation of the current 65.5 cent property tax rate, an increase in the senior/disabled property tax exemption and a continuation of the current charges for water and wastewater service.

The FY03 budget was extraordinarily difficult to develop. The primary cause of this difficulty related to the growth in expenditures (e.g., increases in public safety compensation, continuation of four-on-a-truck firefighter staffing levels, increases in debt service, increases in health and property insurance costs and the fulfillment of my pledge to replace \$50 million in street improvement funding previously provided by METRO) that have not been matched by growth in existing revenues. When combined with inflation, population growth, and the moderating of our economy, these costs created a structural imbalance between recurring revenues and recurring expenditures in FY02. The FY03 budget is balanced without the use of substantial non-recurring revenues.

The critical problems that must be faced in FY04 include (a) inadequate long-term funding source for drainage improvements, (b) deteriorating financial condition of our water and wastewater system, exaggerated by the use of water funds in past years for other important needs in our city, and (c) inadequate cash reserves in the General Fund. This budget letter suggests a strategy to correct these deficiencies during FY03.

OVERVIEW-ALL FUNDS

The City's operating budget consists of the General Fund and numerous Enterprise and Special Revenue Funds, including the Aviation Fund (which supports our large and expanding airport system), the Water and Wastewater Fund, and the Convention and Entertainment Facilities Fund. A brief discussion on each of the City's operating funds can be found in this document on Pages I-7 through I-10. Overall, the adopted budget totals \$2.629 billion. Of this amount, \$1.468 billion (56%) is for public infrastructure and \$801.8 million (31%) is for public safety.

GENERAL FUND HIGHLIGHTS

The City's General Fund is its largest fund and includes the majority of the traditional services performed by the City departments. As such, decisions effecting the General Fund revenues and expenditures tend to be the most important to our citizens. As an example, police and fire protection, street work, libraries and parks are all largely funded by General Fund revenues.

Historical Perspective – Houston's population has grown approximately 2% annually since FY98, the last year of the prior administration. The FY98 budget, including the \$50 million received from METRO totaled \$1,132.9 million or \$608.43 per thousand residents of Houston (population assumed to be 1,861,705 according to the Greater Houston Partnership data). The FY03 budget is \$1,428.9 million or \$695 for every thousand residents (we now have approximately 2,055,472 residents). During this same five year period, inflation averaged 2.7% per year. Adjusting the FY2003 budget to account for inflation results in a budget of \$600.90 per 1,000 citizens, substantially less than in FY98. City government cost, in real terms, is less per citizen than it was when I became Mayor.

Nevertheless, in non-deflated total dollars, the FY03 budget is \$346.5 million larger than actual FY98 spending. Where has this increase gone? The following table provides the answer:

Police and Fire staffing and compensation.....	\$162.0 million
Health and property insurance.....	48.1 million
Debt service on bonds to support capital projects.....	52.5 million

These three categories alone explain 76% of the nominal increase.

During my tenure as Mayor, City staff has decreased in every category except for uniformed police and firefighters. When compared to the population growth, this decrease is even more dramatic. We are operating the non-law enforcement sector of the city today with 16.7% less staff per capita than in FY98. This is a testament to greater efficiency as well as hard work on the part of our loyal employees.

GENERAL FUND REVENUES

Overview - General Fund Revenues are conveniently divided into four categories, as shown on Table I: (1) recurring revenues calculated with the assumption of no fee increases, (2) non-recurring revenues, (3) revenues exactly offset by equal expenditures (“pass-throughs”) and (4) additional revenues dependent on City Council action. Of the recurring revenues, property and sales taxes, and franchise fees comprise over 87% of revenues, and are largely out of the control of City Council unless tax rates are specifically raised or lowered.

Recurring Resources with No Fee Increases - Our largest sources of revenues are property tax, sales tax and franchise revenues, and municipal courts revenue. Overall, the budget is based on a projection of revenues equal to \$1.33 million, before “pass through” revenues such as the cost of airport security. This is a 3.9% increase over expected FY02 recurring revenues. With the new revenues discussed below, revenue will be 4.9% higher than FY02 revenue.

Property Tax – The adopted budget contains a revenue estimate of \$654.1 million (4.7% increase over FY02 revenue), based on Harris County Appraisal District’s projection of a \$101.2 billion tax base and the continuation of the 65.5 cent tax rate. The growth in the property tax base has slowed considerably (see chart below) in the most recent appraisal with an increase of approximately 4.4% in growth compared to a growth rate of between 8.7% and 9.6% for the past three years. The tropical storm damage and a general slowing of the energy sector have resulted in the changes we are experiencing.

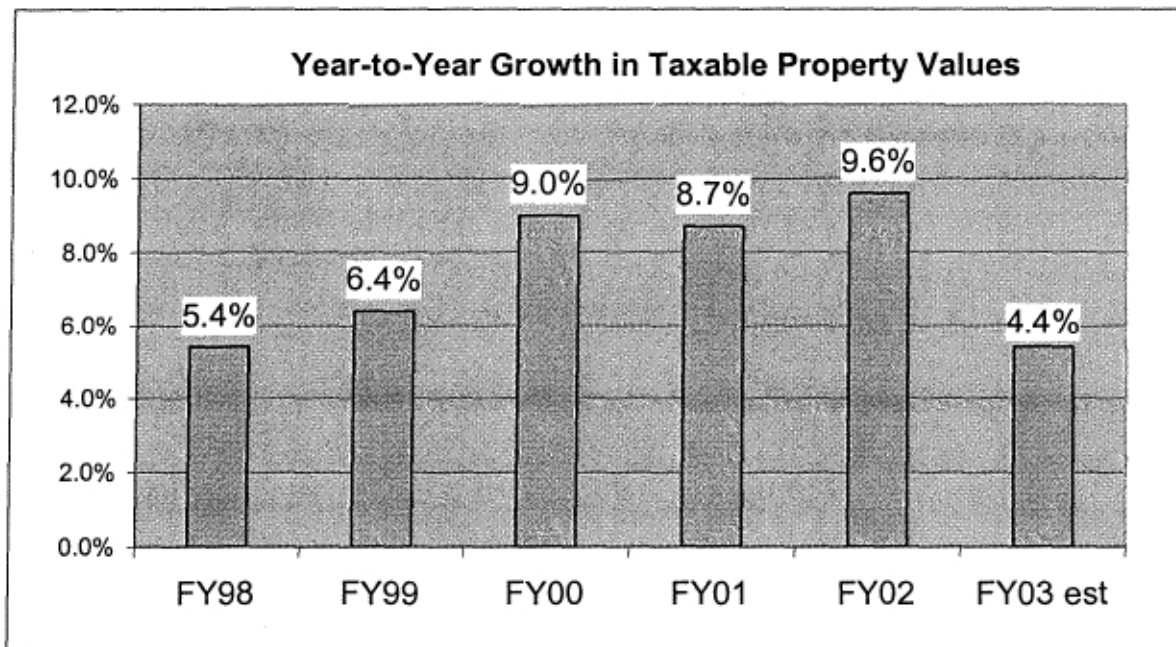


TABLE I

ADOPTED BUDGET SUMMARY**GENERAL FUND**

(\$1,000)

Category	FY02	FY03	Difference
1 <u>Recurring Revenues</u>			
Property Tax	624,438	654,070	29,632
Sales Tax	340,983	356,087	15,104
Electric Franchise Fees	85,751	78,200	(7,551)
Telephone Franchise	57,771	58,458	687
Municipal Courts	36,352	44,940	8,588
Ambulance Fees	17,300	18,400	1,100
Industrial Assessments	16,260	16,000	(260)
Charges for Services other than ambulance	14,889	15,132	243
Indirect Cost Recovery	14,010	15,373	1,363
Gas Franchise Fees	13,474	13,550	76
Cable Franchise Fees	10,800	8,600	(2,200)
All Other Recurring	50,337	53,435	3,098
Subtotal-Recurring Revenue	1,282,365	1,332,245	49,880
2 <u>Non-Recurring Revenues</u>			
ALP Transfer	20,000	0	(20,000)
Metro Transfer	10,000	0	(10,000)
Subtotal-Nonrecurring Revenue	30,000	0	(30,000)
Subtotal-Recurring and Non-Recurring	1,312,365	1,332,245	19,880
3 <u>Revenue Directly Offset by Expense</u>			
Interfund Police and Fire	34,678	40,281	5,603
Interfund Engineering	21,635	24,085	2,450
Interfund-Other	9,912	14,347	4,435
Limited Purpose Annexation	750	5,000	4,250
Subtotal-Revenues Directly Offset by Expense	66,975	83,713	16,738
Total Revenues before Fee Increases	1,379,340	1,415,958	36,618
4 <u>Additional Revenues</u>	0	12,955	12,955
Total Revenue	1,379,340	1,428,913	49,573
Total Expenditures	1,379,340	1,428,863	49,523
Surplus of Revenues Over Expenditures	0	50	50

Senior/Disabled Exemption – For many years, the City’s senior/disabled exemption has been \$34,006. This budget increases this exemption to \$40,000. City Council also established a policy to increase this exemption by 10% in each of the next five fiscal years.

Increases in Recurring Revenue Based on Fee Increases - In FY01, the City engaged a consultant to analyze the costs of providing certain services. As a result, this budget increases charges for health, fire, police, and ambulance services to be more representative of the costs to provide such services. These higher fees are expected to increase revenues by \$5.0 million per year.

New Fees – The City Council adopted three new fees which are incorporated into this budget: (a) a fee for commercial waste haulers, (b) a fee for citizens who require additional solid waste capacity, and (c) a fire alarm permit fee. In total, these fees are expected to add \$8.0 million in revenue to the General Fund in FY03.

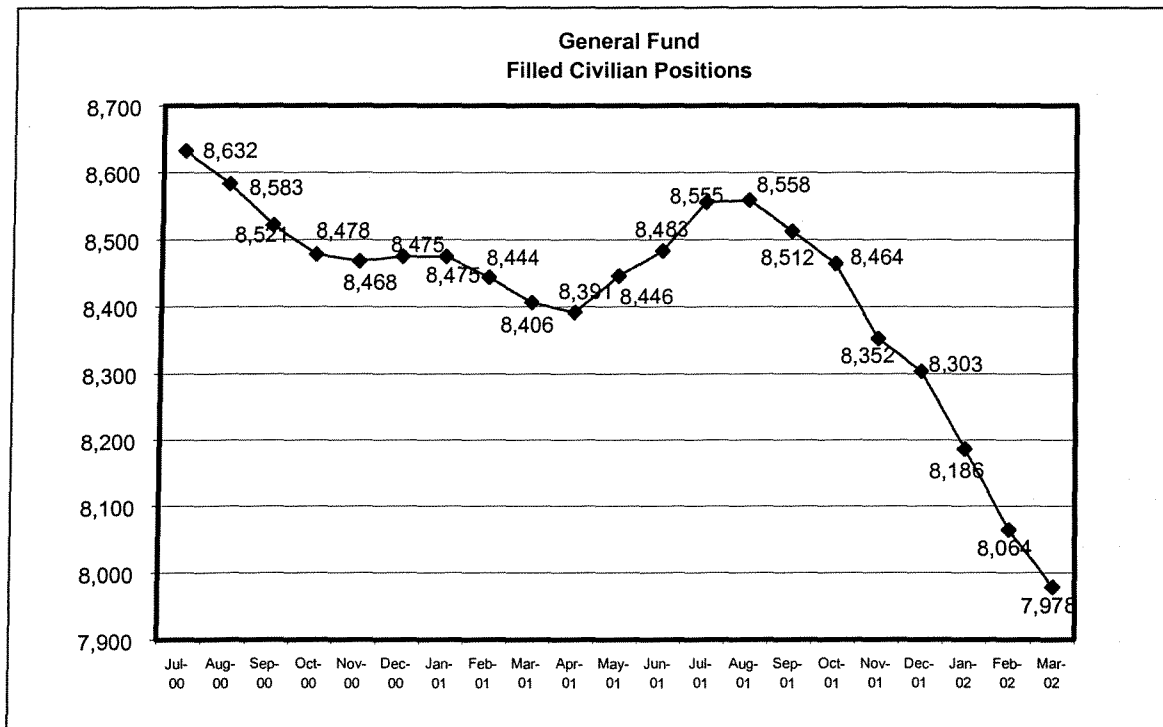
GENERAL FUND EXPENDITURES

Overview - General Fund budgeted expenditures are \$1.429 billion. This compares to FY02 expenditures totaling approximately \$1.376 billion; about a 3.85% increase. When HPD, HFD and debt service budgets are removed, the expenditure picture is as follows: FY03 expenditures are at \$505.4 million, as opposed to \$504.3 in FY02 essentially unchanged despite higher health and property insurance costs. In essence, higher mandated costs in public safety and debt service have been offset by lower departmental expenditures, as explained more fully below.

Departmental Budget Reductions During FY02 – In recognition of the slowing economy and the budget difficulties anticipated in FY03, reductions in supply and travel line items and a zero-base approach to hiring were established midway through FY02. Rather than being allowed to hire staff approved in the FY02 budget, department directors were required to provide additional justification throughout the year, to a Position Control Committee. As a result of this step, civilian staffing was decreased significantly, as demonstrated in the chart on the following page.

Departmental Budget Targets in FY03 – The budget targets established for FY03 included further cuts, aggregating \$18 million initially, as we attempted to cope with additional uncertainty and increasing costs related to HPD Meet and Confer commitments, HFD staffing, health and property insurance increases, debt service increases, and the final installment on my pledge to return \$50 million to METRO. Many of the FY03 budgets result in service diminishment, although staff is being reduced only by attrition and core services continue to be delivered at acceptable levels.

Certain small increases were made to departmental budgets for the following reasons (a) to add staff that would be charged to CIP projects as we embark on the recently approved expanded CIP, and (b) to add staff for new facilities that will open in FY03. In particular, two libraries, an additional kennel, a small engine repair shop, and a fire station are included in this category.



Departments will be forced to find efficiencies and in some cases curtail service delivery. For example, most libraries will be operated on a one-shift basis, which will result in fewer hours of operation per week. Police helicopter hours will be reduced. I believe these service curtailments are necessary to allow the City to reach its goal of well-paid police and fire officers sufficient to adequately protect the public. This public safety goal is the number one priority of a majority of the City Council and cannot be accomplished without making certain sacrifices in other areas.

Street Overlay Funding – In past years, we have performed street overlay work with City crews in the General Fund and with contract crews in the CIP. The city work generally can be performed at a lower budgetary cost, given the existing equipment infrastructure at the City. The FY03 budget includes the conversion of all overlay work to city work in FY03 and provides that a full study, perhaps resulting in a managed competition, be performed by mid-year to determine our future direction. In FY03, this process offers budgetary savings and more miles of overlay than could be performed under the previous method.

Continuous Management Improvement - Several management improvement initiatives are included in the FY03 budget and are expected to save an estimated \$3.9 million. Such initiatives include outsourcing certain functions; installation of IP telephony; and a thorough review of all supervisory positions to revise spans of control.

TABLE II

ADOPTED DEPARTMENTAL BUDGET SUMMARY**GENERAL FUND**

(\$1,000)

<u>Departments</u>	<u>FY02 Budget</u>	<u>FY02 Estimate</u>	<u>FY03 Budget</u>	<u>Difference</u>
Affirmative Action	2,012	1,884	1,822	(62)
Building Services	32,619	30,775	30,549	(226)
City Council	4,428	4,325	4,135	(190)
City Secretary	851	782	765	(17)
Controller	6,559	6,368	6,170	(198)
Finance and Administration	20,608	19,570	18,513	(1,057)
Fire	252,548	268,634	283,148	14,514
Health and Human Services	58,089	55,933	56,018	85
Human Resources	3,066	2,981	2,890	(91)
Information Technology	13,132	13,025	10,585	(2,440)
Legal	11,118	10,992	10,765	(227)
Library	37,442	35,844	34,913	(931)
Mayor's Office	1,960	1,943	1,822	(121)
Municipal Courts - Administration	16,643	16,343	16,620	277
Municipal Courts - Justice	4,027	3,874	3,903	29
Parks and Recreation	56,737	55,971	55,337	(634)
Planning and Development	17,133	16,520	15,937	(583)
Police	441,656	447,157	462,348	15,191
Public Works and Engineering	99,819	93,606	91,061	(2,545)
Solid Waste Management	<u>63,091</u>	<u>61,366</u>	<u>61,051</u>	<u>(315)</u>
Subtotal Departments	1,143,538	1,147,893	1,168,352	20,459
Transfer to HEC	0	0	7,763	7,763
Reserve for Compensation	0	0	10,000	10,000
Pass Through for Limited Annexation	0	750	5,000	4,250
General Government - Other	58,517	58,018	59,748	1,730
Debt Service	<u>169,000</u>	<u>169,000</u>	<u>178,000</u>	<u>9,000</u>
Subtotal General Government	227,517	227,768	260,511	32,743
Total	<u>1,371,055</u>	<u>1,375,661</u>	<u>1,428,863</u>	<u>53,202</u>

NOTE: FY02 has been restated to include organizational changes and transfers from one department to another after the beginning of the year.

Compensation and Benefits - The adopted budget includes funds for a modest pay raise for civilian City employees. A 3 ½ % across-the-board raise for all personnel below grade 29 and a 2% pay-for-performance pool for managers in grades 29 and higher are included. Civilian employees have not had a pay raise in 29 months and are currently 27% behind the market. In addition, the City Council approved changes in the health benefit plan, which increases employee co-payment requirements and decreases City costs.

ORGANIZATIONAL CHANGES

The adopted budget contains four changes in the organization that will improve management or clarify our presentation. These changes are discussed below:

Separation of Information Technology (IT) from Finance and Administration - The creation of the IT Department involves a recognition of an existing arrangement rather than a reorganization, since no personnel are added and no reporting relationships change as a result of this budgetary clarification.

Combination of One-Stop Business Center with Affirmative Action - Since the One-Stop Business Center no longer functions under the supervision of the Housing and Community Development Department, this function has been combined with Affirmative Action.

Creation of the Houston Emergency Fund - With the opening of the Houston Emergency Center, a central organization structure for all emergency coordination will better serve the public. The 9-1-1 Emergency Network Fund is being renamed the Houston Emergency Center Fund and will encompass aspects of the old 9-1-1 organization, our emergency management function previously budgeted in F&A, and HPD and HFD dispatch personnel. The new fund will function with contributions from the General Fund and from the County 9-1-1 budgets.

Reorganization of the Neighborhood Protection Division - The change moves 109 positions from the Public Works Department to the Planning and Development Department and eight positions from Public Works to the Houston Police Department. This change will improve our response to neighborhood issues and allow the Public Works Department to concentrate on its core missions of street and drainage construction and repair and water and wastewater conveyance. No cost is associated with this organizational change.

RAINY DAY FUND/ENDING BALANCE

The City Council adopted a policy of returning excess insurance reimbursement to the City's Rainy Day Fund rather than returning it to the Water and Wastewater Department's "Any Lawful Purpose Fund." The estimated increase in the Rainy Day Fund is \$14.7 million although the exact amount will be based on final arrangements with our insurance carriers and FEMA.

The General Fund Ending balance, including the Rainy Day Fund, is projected to be \$99.9 million, or \$14.3 million above the FY02 estimated ending balance.

ENTERPRISE FUNDS HIGHLIGHTS

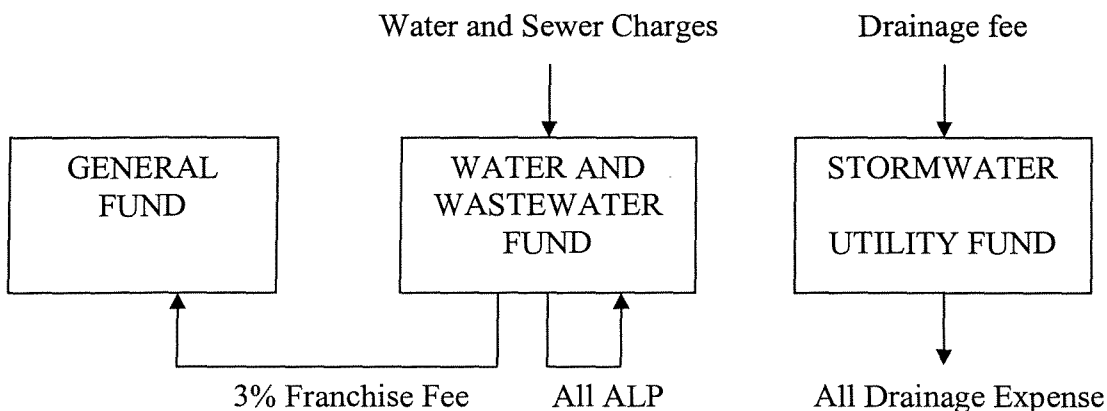
Stormwater Utility Fund and Water and Wastewater Fund

The adopted budget includes the first step toward creation of an independently-funded Stormwater Utility Fund (formerly the Street & Drainage Fund). Although we have a drainage CIP program (approved by the voters) totaling \$110 million, creation of a Stormwater Utility Fund will potentially augment these funds in the years to come.

I believe a new funding source is needed if we are to make meaningful improvements in our drainage infrastructure. The two most logical sources of additional funding are additional taxes to support General Obligation debt, or a separate fee to support either a pay-as-you-go system or as security for revenue debt. Both strategies have merit, although I believe the most versatile approach is a fee based on the drainage load imposed by each property.

Accordingly, I am requesting the City Council consider during FY03 the following fundamental change in the financing of our water and drainage facilities:

- A new fee of \$3.00 per month for residents and greater amounts for businesses to be dedicated exclusively to drainage;
- Reduction of the current 5% “franchise fee” that is currently removed from the water and wastewater system to fund our drainage and National Pollution Discharge Elimination System (NPDES) program to 3%, with the amount going exclusively to the General Fund as reimbursement to the “owners” of the public infrastructure. The use of the money would be determined by the City Council during the annual budget process. I suggest that the first use of this additional revenue should replace the ditch mowing work (approximately \$4 million) currently being performed in Fund 227, and thereafter to build our ending balance and/or to contribute to the Rainy Day Fund;
- Other than the 3% franchise fee charged the Water and Wastewater Fund, I propose the complete closing of the ALP mechanism. That is, all additional surplus funding above the 3% franchise fee to the General Fund would be reinvested in our water and wastewater system, as illustrated below:



The recommendations above will provide approximately \$80 million per year in funding to improve our drainage; approximately \$15 million per year for General Fund purposes (the first such purpose being to increase our ending balance and our Rainy Day Fund; and provide significant reinvestment in our water system to lessen a rate increase that will probably be necessary in future years.

Aviation Fund

Our aviation facilities have recovered well from the events of September 11th. Passenger traffic is projected to resume a growth pattern of 4% higher than FY02, a year of decline. The Aviation Fund budget reflects this growth and the financial pressures associated with enhanced security levels, which will meet or exceed the guidelines established by the FAA.

The budget accomplishes the following priority objectives: secure and safe airport facilities; continued implementation of expansion programs at Bush Intercontinental and Hobby Airports; continued efforts to expand passenger and cargo activity with particular emphasis on Pacific Rim and Latin American countries; continued development opportunities at Ellington Field; and implementation of job order contracting as a pilot project for the entire city.

Convention and Entertainment Fund

The Convention and Entertainment (C&E) Facilities budget reflects the continuation of our aggressive policy of maintaining city properties to state-of-the-art standards and enhancing the downtown area. Economic uncertainty has resulted in a projection of only a modest increase in hotel-motel tax revenues, the lifeblood of C&E operations. While FY02 showed revenue declines due to the flood and reduction in tourism, more growth is anticipated in FY03.

Jones Hall, the Wortham Center, and all parking facilities damaged by Tropical Storm Allison were quickly restored to full operation. The Hobby Center recently had its grand opening. Other significant signs of our progress are the groundbreaking of the 1,200 room convention center hotel and the expansion of George R. Brown Convention Center. Both of these projects are on schedule.

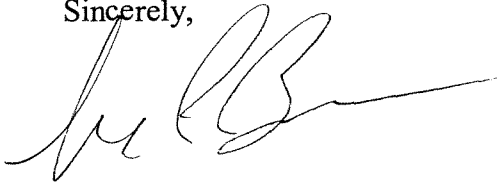
The Convention and Entertainment Facilities Department will assume responsibility in FY03 for the City's contracts with the Greater Houston Partnership, Houston International Initiatives, and the Clear Lake Economic Development Foundation. This shift has the potential to create more collaborative marketing opportunities between the local organizations and the Greater Houston Convention and Visitors Bureau, resulting in efficiencies and more positive media attention.

SUMMARY

The budget was adopted on schedule after active debate by the entire City Council and the consideration of numerous amendments. I am grateful to the Houston City Council for its hard work in making and debating suggestions for budgetary improvement in a professional manner. Our financial circumstances are difficult. However, this budget represents a solid foundation for adequate service delivery and a strengthening of our financial posture. With the economic downturn behind us, I am hopeful that the coming year will be characterized by less uncertainty than we experienced in FY02 as we continue to improve our organizational effectiveness.

Houston is on the right track. There is much to be proud of. I wish to acknowledge the City Controller, the members of the City Council, our local community leaders and all City employees for their contributions to our progress.

Sincerely,

A handwritten signature in black ink, appearing to read 'Lee P. Brown', with a long horizontal flourish extending to the right.

Lee P. Brown
Mayor